

(916) 369-4900

August 20, 1990

FTB Notice 90-5
410:BRL:CN-90-467

Re: DOMESTIC (NONFOREIGN) NONRESIDENT PARTNER WITHHOLDING
GUIDELINES

Note: These guidelines do not relate to foreign (non-U.S.) partners. Foreign partner withholding is 9.3% of the amount determined in accordance with federal IRC Section 1446.

Following are common questions regarding domestic (nonforeign) nonresident partner withholding and their answers.

WHEN IS A PARTNERSHIP REQUIRED TO FILE A CALIFORNIA RETURN?

1. Who must file a California partnership return, Form 565?

A. Every partnership that engages in a trade or a business or has income from sources in California must file Form 565 (Partnership Return of Income). This includes religious and apostolic organizations that are exempt from tax under Internal Revenue Code Section 501(d). The "small partnership" exception contained in IRC Section 6031 does not apply in California. See FTB Notice CR-88-692.

2. Can a syndicate, pool, joint venture or similar organization elect not to be treated as a partnership for state income tax purposes?

A. Yes. A syndicate, pool, joint venture or similar organization may elect under Internal Revenue Code Section 761(a) (which California follows) not to be treated as a partnership for state tax purposes and will not be required to file Form 565 except for the year of election.

3. What if the partnership does not do business in California and does not receive income from California sources but has partners who are California residents?

A. The filing of Form 565 is not required in this situation. However, if such a partnership elects to compute income for California purposes in a manner different from the method used to compute income for the partnership's federal return (for example, a different method to compute installment sales), then a separate California partnership return must be filed.

WHEN IS WITHHOLDING REQUIRED?

4. When is a partnership required to withhold?

A. Under California Revenue and Taxation Code Sections 18805 and 26131, withholding at source is required when the partnership is notified to withhold by the Franchise Tax Board. (See also Title 18 Cal. Code of Regs., Sections 18805-1 to 18805-8, and Sections 26131-1 to 26131-5.) Notifications to partnerships are now being mailed by the Franchise Tax Board.

Once the partnership receives notice, it should begin withholding on distributions of income (including prior year income which should have been but was not previously reported as income from California sources) to its nonresident partners. However, no withholding is required if distributions of income from California sources to the partner are \$1,500 or less during the calendar year.

If a partnership anticipates encountering administrative problems in applying the withholding requirements for the first few distributions while in the process of implementing a withholding program, it should submit a written request for a waiver to the Withhold at Source Unit. These requests will be handled on a case-by-case basis.

5. When will notice be sent to the partnerships?

A. Over 220,000 notices are now being sent to all partnerships which filed returns in 1989. The first 70,000 notices were sent in July and the remainder will be sent over the next several months. Notices will be mailed annually to those partnerships that were not notified in prior years and notice will be constructively given yearly in the Form 565 (Partnership Return of Income) forms and instructions.

6. To what extent will partnerships that have California source income but do not receive the notice because they did not file returns, be considered to have been notified and hence be required to withhold?

A. In the case where the partnership files its first year return during the year, the Franchise Tax Board will not consider the partnership to have been notified until the end of that calendar year when the partnership files its California return (Form 565). This is when notice will be given to the partnership through the Form 565 forms and instructions of the requirement to withhold for subsequent years. However, where a partnership was required to file returns but did not do so, notice will be considered as constructively received by the partnership.

7. Can a partnership withhold prior to receiving notice from the Franchise Tax Board (FTB)?

A. Yes. The Franchise Tax Board will accept withholding prior to the notices being received. No penalties for failure to withhold can be assessed until after the partnership receives notice, and then fails to withhold.

8. If the distributions to a nonresident partner are anticipated to go over \$1,500.00 during the year, when is the withholding required to be done? At the first distribution or when the distribution exceeds the \$1,500.00?

A. If it is anticipated that total distributions of California source income to a nonresident partner will exceed \$1,500.00 during the calendar year, withholding must be done on all distributions of income made to that partner. It should be noted that if more than \$1,500.00 is distributed to a nonresident partner, the entire amount of all distributions of income are subject to withholding, not just the amount in excess of \$1,500.00.

9. If a distribution of income to a nonresident partner of \$1,000.00 is made during the portion of the year prior to receipt of notice by the partnership and a distribution of income of \$800.00 is made to the same partner later in the same calendar year after receipt of the notice, what amount is subject to withholding?

A. The FTB will not subject the distribution made prior to notification to withholding. However, as the total distributions for the calendar year exceed \$1,500.00, the distribution of \$800.00, made after notification, is subject to withholding.

WHAT INCOME IS SUBJECT TO WITHHOLDING?

10. What amounts are subject to withholding?

A. All distributions, including property, which represent California source taxable income are subject to withholding. This is different than the foreign partner withholding under California Revenue and Taxation Code Section 18807 which is based on allocations (not distributions) of income.

11. What if the partnership has no taxable income? Does the partnership need to request a waiver from withholding?

A. No. It is up to the partnership to determine whether the distribution represents taxable income. If the distribution is determined to be a return of capital, or of previously taxed

income, or does not represent taxable income, no withholding is required. Although the FTB is not requiring a waiver in this situation, if upon audit the FTB determines that withholding should have been done on a distribution, the partnership may be liable for the withholding.

12. What if the distribution, in whole or in part, does not represent taxable income?

A. The partnership must make an allocation of the portion of the distribution which represents taxable income and withhold 7% on that amount. No request for a reduced rate or waiver is required.

13. What if the partnership has no California income or assets, but is making distributions to its nonresident partners?

A. As long as the partnership is not engaging in a trade or business in California and does not have income from sources in California, no withholding is required and no request for a waiver or reduced rate is required.

14. What if the partnership has income from within and without California?

A. The partnership must make a reasonable approximation of the ratio of its income from California sources to its worldwide income, and apply that ratio to the distributions of income to determine the amount subject to withholding. The 7% withholding rate is then applied to this amount. If a partner's allocable share of this amount is less than \$1,500 for the calendar year, then no withholding is required on distributions to that partner and no waiver request is required.

15. Are guaranteed payments to partners subject to withholding?

A. Yes, if the guaranteed payments represent income from California sources for the nonresident partners and are not subject to wage withholding through EDD.

16. Are distributions of property subject to withholding?

A. Yes. If the distribution of property represents income, withholding is required based on the fair market value of the property distributed.

ENTITIES SUBJECT TO WITHHOLDING

17. Is withholding required when the partnership makes distributions of income to other partnerships, corporations, Master Limited Partnerships (MLP'S), or exempt organizations?

A. Withholding at source is required on all distributions of income made to domestic nonresident partners unless a waiver is obtained. Domestic nonresident partners include individuals, partnerships, estates and trusts, and corporations which are not qualified to do business in this state. However, waivers on distributions by publicly-traded partnerships, and on distributions to brokerage firms, tax exempt organizations, and tiered partnerships (including S Corporations) will generally be approved upon written request.

18. Are S Corporations required to withhold on distributions to their nonresident shareholders?

A. The FTB currently is not requiring withholding on distributions made by S Corporations. However, this area may undergo study. Withholding by S Corporations will not be required unless notice is received from the Franchise Tax Board.

19. Is withholding required on trust or estate distributions?

A. Withholding per California Revenue and Taxation Code Section 18805 currently requires withholding on income from California sources distributed to nonresident beneficiaries. Instructions for Form 541 (California Fiduciary Income Tax Return) explain the withholding requirements.

WAIVERS

20. What address should be used to request a waiver or a reduced rate of withholding?

A. Withhold at Source Unit, Attn: Request for Waiver, Partnership Withholding, P.O. Box 651, Sacramento, CA 95812.

21. How soon will we get a response to our request for a waiver or reduced rate?

A. The Withhold at Source Unit anticipates a response within 2 to 4 weeks. Where situations are more complex, additional information or documents may be needed.

22. Are there any emergency procedures to obtain a quicker turn around of waiver requests when distributions are made on short notice?

A. If a rush response is needed the Withhold at Source Unit has a facsimile (FAX) machine available. The Withhold at Source Unit should be contacted in advance so that the request can be coordinated.

23. Will a waiver be granted if the partner consistently files and makes estimate payments?

A. Yes. However, a waiver must be requested as the partner's estimate payments and filing history must first be verified by the FTB.

24. Who must request a reduced withholding rate or waiver, the partnership or the partner?

A. Either party may request a reduced withholding rate or waiver.

25. If a partnership puts up a bond, deposit or otherwise, will this satisfy the withholding requirements?

A. The Withhold at Source Unit will review all written requests for alternatives to withholding. The FTB will be as helpful as possible in assisting partnerships in implementing their program of withholding on distributions.

26. What information is required on the request for waiver? Is there a form?

A. There is no standard form available at this time. However, a form will be developed for this purpose. Requests must be in writing and contain all pertinent facts to support the request, including partnership account number, partners' names and social security numbers. If insufficient information is provided, the waiver may be denied. In addition, additional information or documents may be requested.

27. If a partnership is already filing a composite return for nonresident partners and making estimate tax payments under existing rules, can it get a waiver from withholding?

A. Yes. In general, partnerships filing composite returns and making estimate payments will be granted waivers from withholding.

28. Will waivers be granted on an annual or other extended-term basis, or must a waiver be obtained for each distribution?

A. Requests for reduced withholding rates and waivers will be considered on an individual basis. Authorizations may be one-time, annual or longer.

PAYMENTS

29. When is withholding due?

A. Withholding is due to be remitted to the FTB by the 20th of the month following the date of distribution of income. Withholding is not required to be submitted until total amounts withheld by the partnership with respect to all nonresident partners exceed \$2,500 for the calendar year. If amounts withheld do not exceed \$2,500 for the calendar year, the withholding is required to be remitted to the FTB by January 31 of the following year. These requirements are explained in the Form 592 (Return of Tax Withheld at Source) instructions.

FTB FORM 590, CERTIFICATE OF CALIFORNIA RESIDENCE (INDIVIDUALS)
OR PERMANENT PLACE OF BUSINESS (CORPORATIONS)

30. How does a partnership determine if an individual is a resident or a qualified corporation?

A. If a partner claims not to be subject to the withholding requirements, have them complete and sign FTB Form 590, Certificate of California Residence (Individuals) or Permanent Place of Business (Corporations). The partnership should retain this form and not send the Franchise Tax Board a copy.

31. Can a partnership assume that partners whose mailing addresses are in California are California residents?

A. Discretion is necessary in relying on California mailing addresses as an indication of a partner's resident status. This assumption is not always correct, and the partnership should exercise caution in relying upon mailing addresses. Caution especially should be exercised where the address is a post office box or when the address is "in care of" another. The partnership can avoid potential penalties by securing a current Form 590.

32. Should Form 590 be completed annually?

A. Form 590 should be completed at the beginning of the withholding program and should be completed again when any changes in residency occur.

PENALTIES

33. Under what circumstances will penalties be imposed?

A. Prior to Notice, the FTB will not pursue the partnership for taxes, penalties or interest for failure to withhold on distributions to domestic nonresident partners. After Notice, partnerships which fail to withhold will be at risk for taxes, penalties and interest.

34. What penalties would apply in the event of failure to withhold?

A. Liabilities incurred for failure to withhold include liability for the tax withheld or the amount of tax due from the taxpayer to whom the payments are made, limited to the amount required to be withheld, whichever is greater, plus penalties and interest as if it was the payer's tax liability. Late payment (5% plus .5% per month) and negligence (5% plus 50% of the interest) penalties would also be applicable. See California Revenue and Taxation Code Sections 18815, 18684.2, 18684 and 19409 for further information.

35. What if the partnership used an estimate or computation method for determining the portion of the distribution which represents California source income and that estimate or method later proved inaccurate?

A. The FTB expects that there will be differences in what constitutes a reasonable proration of California source income. Penalties will not be imposed on those partnerships which make a good faith effort to comply with the law.

DRAFTING INFORMATION

This notice was written by the staff of the Franchise Tax Board Withhold at Source Unit. For further information regarding this notice, contact the Franchise Tax Board Withhold at Source Unit at P.O. Box 651, Sacramento CA, 95812-0651. The telephone number for the Withhold at Source Unit is (916) 369-4900.